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PENSION SYSTEMS AND LABOUR MOBILITY
Portability of Pensions in EU

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PENSION SYSTEMS AND LABOUR MOBILITY

Portability of Pensions in EU

by Mariliis Ruutma

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Abstract:

The purpose of this study was to investigate the theoretical opportunities and boundaries to the portability of pensions for a cross border worker in the European Union (EU). The intention was to establish if pension systems encourage free movement of labour between Member States. EU regulations regarding pensions and free movement of labour were examined. In addition, the pension systems of Estonia and United Kingdom were studied as examples. The main objective was to discover if there is flexibility in the systems and possibility for portability of pensions of mobile workers.

This dissertation is a secondary research with the aim of gaining insight into the topic. Primary data was received collecting information about the pension systems from the official portals of European Commission and pension authorities. Secondary data was mainly qualitative, gathered from reports, articles, researches and other similar publications.

It was found that the pension systems are an internal affair of the Member States without Union wide harmonization. However, to encourage free movement, EU coordinates cross border activity of social security issues including pensions. This has had a direct positive influence on the portability of both Estonian and British state pensions. The countries pay the statutory pensions to those eligible irrespective of where in EU they reside and also the principle of aggregation is implemented. The supplementary private pension schemes lack an equivalent EU regulative framework. This is reflected in less clarity for mobility options and represents an obstacle for free movement of labour.

Keywords: free movement of labour, European Union, portability of pension, pension system in Estonia, pension system in UK, pensions

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Tiivistelmä:

Tämän tutkimuksen tavoitteena oli tarkastella kotimaansa rajojen ulkopuolella työskentelevien teoreettisia mahdollisuuksia eläkkeen siirtämiseen Euroopan unionin (EU) sisällä ja tätä rajoittavia tekijöitä. Tarkoituksena oli saada selville kannustavatko eläkejärjestelmät työvoiman vapaaseen liikkuvuuteen jäsenvaltioiden välillä, joten tutkimuksessa perehdyttiin EU:n asetuksiin eläkkeistä ja työvoiman vapaasta liikkumisesta. Lisäksi työssä käytettiin esimerkkeinä Viron ja Ison-Britannian eläkejärjestelmiä. Keskeisin päämäärä oli saada selville ovatko järjestelmät joustavia, ja millaiset mahdollisuudet liikkuvilla työntekijöillä on eläkkeen siirtoon.

Tämä opinnäytetyö toteutettiin sekundaarisen tutkimuksen menetelmin, pyrkimyksenä saavuttaa eri näkökulmia aiheeseen. Primääristä materiaalia saatiin keräämällä eläkejärjestelmiä koskevaa tietoa Euroopan komission virallisesta portaalista sekä eläkeviranomaisilta. Sekundäärinen aineisto oli enimmäkseen kvalitatiivista tietoa, jota saatiin raporteista, artikkeleista, aiemmista tutkimuksista, sekä muista vastaavista julkaisuista.

Tutkimuksessa selvisi, että eläkejärjestelmiä pidetään valtioiden sisäisenä asiana, eikä jäsenvaltioiden välille ole luotu yhtenäistä järjestelmää. Vapaan liikkuvuuden edistämiseksi EU kuitenkin koordinoi valtioiden välisiä sosiaaliturvakysymyksiä, eläkkeet mukaan lukien. Tällä on selkeä positiivinen vaikutus sekä Viron että Ison-Britannian valtioneläkkeiden siirrettävyyteen. Kumpikin maa maksaa EU:n periaatteita noudattaen lakisääteiset eläkkeet kaikille, jotka ovat siihen oikeutettuja, riippumatta siitä, missä EU-maassa eläkkeensaaja asuu. Yksityisiä eläkesäästösuunnitelmia varten ei EU-säädöksissä ole vastaavaa toimintamallia. Tämä näkyy epäselvyyksinä liikkuvuusvaihtoehdoissa ja nostaa vapaan liikkumisen kynnystä.

Avainsanat: työvoiman vapaa liikkuvuus, Euroopan Unioni, eläkkeen siirrettävyys, Viron eläkejärjestelmä, Ison-Britannian eläkejärjestelmä, eläkkeet

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1. Introduction

The dissertation is set out to gain understanding of the theoretical opportunities and boundaries to the portability of pensions for an employee who has been working across European Union. The topic was chosen because the free movement of labour and the questions of pensions are both very important subjects. Free movement of labour is one of the key features of the common market in the European Union. The pension systems play a great part in persons' lives, economies, state budgets and financial systems. The design of pensions can promote or restrain the free movement of labour or capital (European Commission, 2010a). The link between the two became interesting to the author as a finance student and a cross border mover herself.

The intention of this study is to establish if pension systems encourage free movement of labour between Member States. The key objective is to discover if there is flexibility in the systems and possibility for portability of pensions of mobile workers. The supportive objectives are to:

- understand the EU laws and framework governing the field of free movement of labour and pension matters of mobile workers.
- examine the pensions systems of Estonia and United Kingdom.
- establish the pension portability opportunities moving out of Estonia or United Kingdom and the compliance with EU regulations.
- discover related issues.

The pension systems of Estonia and UK were chosen based on author's personal interest and ability to access material in the official languages of these countries. The study is limited to the investigation of the mobility of the EU citizens. The rights of third country nationals, even of those residing permanently in EU, are excluded from this research because these often follow different rules and regulations on national level.

This dissertation is a secondary research with the aim of gaining insight into the topic. Deductive approach is used. Primary research is not carried out to limit the scope of this dissertation. The necessary primary data is retrieved from authorities. The websites are used as a resource to gain access to the most up-to-date information. Especially the official portals of various institutions are favoured, such as for example Europa.eu of the European

Union and Pensionikeskus.ee, the official information portal for Estonian Pension System. The secondary data used is mainly qualitative. It is gathered by studying academic journals, articles, reports, researches, etc. It is an exploratory research by nature and hopefully this study will be a basis for a further investigation into the topic.

2. Free movement of labour in EU

The European Union has created a common market among its member states. Free movement of workers is one of the four freedoms forming the foundations of the common market in EU. The other three freedoms are free movement of goods, services and capital. In addition to an economical function of allowing the movement of factors of production, the free freedom of labour has the status of a fundamental right. It has been interpreted in the light that workers are people, not merely objects in production process. (Steiner et al., 2006)

Free movement of workers is believed to be important for EU because it penetrates the full potential of the single market potentially bringing benefits to all citizens. European Commission (2010a) considers greater flexibility in job mobility to support the adjustment capacity of the economy and to strengthen the European social model.

Monti (2010) even sees the transnational labour mobility as pre-condition for Europe’s success in the economy to emerge from the global recession. He asserts that the mobility provides greater employment and faster growth than closed national labour markets would achieve. It is of key importance to euro area where exchange rate and monetary policy tools are no longer available to national authorities. He states that mobility must be encouraged as even in the times of crisis there are jobs which are unfilled in the EU. (Monti, 2010)

2.1 The legal background for mobility

The free movement of workers in EU is secured by Article 45 of the Treaty on the Functioning of the European Union:

1. Freedom of movement for workers shall be secured within the Union.

2. Such freedom of movement shall entail the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment.

3. It shall entail the right, subject to limitations justified on grounds of public policy, public security or public health:

    a. to accept offers of employment actually made

    b. to move freely within the territory of Member States for this purpose

    c. to stay in a Member State for the purpose of employment in accordance with the provisions governing the employment of nationals of that State laid down by law, regulation or administrative action

    d. to remain in the territory of a Member State after having been employed in that State, subject to conditions which shall be embodied in regulations to be drawn up by the Commission

4. The provisions of this Article shall not apply to employment in the public service.

The right of free movement can be seen to comprise of three elements. First is the right to move to another country and to live there. Second is the right to access the job market in the host Member State. Thirdly there are ancillary rights. These are highly important as remove disadvantages to the workers arising from the exercise of the right of free movement, e.g. the right of workers to move family with them; and various social security rights. (Steiner et al., 2006) It is important to notice that these rights are granted for those individual who can be defined as ‘’workers’’, thus for example students and unemployed are excluded.

2.2 Statistics on mobility

The labour force of European Union is estimated to be 225 million, making it the third largest in the world after China and India. (World Factbook, 2011) Today only 2.3% of Europeans live in a Member State different from that of their nationality. In the United States, the proportion of US citizens changing States in the same year is about three times higher (Monti, 2010). Compared to this, Europe is an area of low mobility. Also the research by Eurofound published in 2007 found that ‘’long distance mobility is not common: only 18% of Europeans have moved outside their region, while only 4% have ever moved to another Member State and only 3% outside the Union.’’

The workers’ mobility has slightly increased after the 2004 enlargement of the European Union. This has been mainly due to the workers from newly joined Member States (EU-10) finding employment in the old Member States (EU-15). However, the impact is limited when their proportion in the host country’s working age population is measured. (European Commission, 2006) With the exception of Luxemburg and Belgium, the intra-EU mobility is still substantially lower than immigration from non-EU countries. (Dodson, 2008) This can be seen from Table 1 that provides data on EU-15 countries (Italy is excluded since it does not aggregate its labour force based on nationality). The reason for larger number of non-Europeans overcoming the barriers of mobility and entering EU labour market could partly lie in stronger push and pull factors. The higher percentage of intra-European mobility to Luxembourg and Belgium can be explained by the presence of EU institutions.

	Nationality %			
Country	**National**	**EU-15**	**EU-10**	**Non-EU**
Belgium	91.3	5.8	0.2	2.8
Denmark	96.4	1.1		2.4
Germany	89.5	2.8	0.7	7
Greece	94	0.3	0.4	5.3
Spain	90.5	1.2	0.2	8.1
France	94.4	1.9	0.1	3.6
Ireland	92.3	3	2	2.8
Luxembourg	57.9	37.6	0.3	4.2
The Netherlands	95.7	1.4	0.1	2.8
Austria	89.2	1.9	1.4	7.5
Portugal	97	0.4		2.6
Finland	98.3	0.4	0.3	1
Sweden	94.8	2.3	0.2	2.7
UK	93.8	1.7	0.4	4.1

Table 1. Residents working age by nationality, 2005. Source: European Commission, 2006, p.17

The data available on mobility of workers in EU is limited. (Eurofound, 2010) There are not available completely comprehensive figures on mobility of workers because free movement means people often do not need to register. For example a stay of less than three months needs not to be declared.

Though the available data on the movement seems to suggest that there are factors hindering to inter-European mobility, no certain conclusions can be drawn about the nature of the obstacles. However, Eurobarameter surveys carried out in 2009 show that the majority of Europeans are not interested in or consider too complicated working elsewhere in the EU. Nearly every fifth European (17%) envisaged working abroad in the future, while 54% were not interested or saw too many obstacles. (European Commission, 2010b)

2.3 The barriers to mobility

The common barriers to mobility in the multinational Europe are language and culture problems. Other significant issues for migrant workers are: recognitions of qualifications, work permits, taxes, social security, family, family patterns and housing market structure (Monti, 2010).

Abbott (1996) points out that even the investigation of mobility of students and young researchers identified that in addition to language and cultural problems, differences of taxation and social security laws between Member States discouraged mobility. In addition to the complexity of coexistence of different social security systems, other obstacles were named in the European Commission's EU Citizenship Report 2010:

- burdensome procedures for recognising academic diplomas and professional qualifications
- incorrect application of EU law
- cumbersome administrative procedures

The frustration over dealing with different systems is further worsened by complex cooperation between national social security institutions leading in delays and difficulties in exchanging citizens' social security information. (European Commission, 2010b)

In 2010 Eurobarometer conducted a study investigating the experiences of European citizens exercising the right to intra-EU mobility. It interviewed people who had recently moved to another Member State and those who had already returned to their home country. The findings revealed that the most common problem experienced is the lack of clarity in administrative requirements. This is created mainly by three elements:

- difficulty in understanding the administrative processes due to language differences
- local administration staff unaware of EU citizens' rights

- differences between the social security systems of Member States

The respondents to the survey also provided suggestions for improvement. These included for example taking measures to make it easier to open bank accounts in new Member State; accepting official documents (e.g. civil status certificates) in all Member States without further formalities; and providing information about comparative tax, social security and pension provision.

3. Portability of pensions in EU

The European Parliament and the Council are set to make improvements in the field of social security, among other measures, in order to enable free movement for workers. The Treaty on the Functioning of the European Union provides in the Article 48:

1) aggregation, for the purpose of acquiring and retaining the right to benefit and of calculating the amount of benefit, of all periods taken into account under the laws of the several countries;
2) payments of benefits to persons resident in the territories of Member States.

The aggregation principle is intended to guarantee that people, when changing employment and moving to another state, do not lose out on benefits for which certain conditions must be fulfilled. It means that periods of insurance, residence and employment completed in another Member State must be considered. The principle of portability secures payments of the benefit irrespective of where is the territory of EU the receiver is situated. This is applicable to certain benefits, including old age pension. (Fairhurst, 2006) In addition, there is the principle of equal treatment. (Europa.eu, 2011a) This guarantees the same rights and obligations to residents of a country as to the citizens of that particular Member State.

The following aspects of social security are coordinated with Regulation (EC) No 883/2004 and Regulations 987/2009 applying to national legislations:

- sickness benefit
- maternity and equivalent paternity benefits
- accidents at work
- occupational diseases

- invalidity benefits
- old-age pensions
- survivors' benefits
- death grants
- unemployment benefits
- family benefits
- pre-retirement benefits

These regulations apply to citizens of European Union, Norway, Iceland, Lichtenstein and Switzerland. Only some countries have chosen to extend the rights in certain cases to non-EU nationals. The social security coordination is not restricted to workers; it concerns also self-employed, students, civil servants etc. (Fairhurst, 2006)

Resulting from Regulation (EC) No 883/2004 and Regulations 987/2009, the old age pensions in EU are paid out buy each Member State where the employer has worked. The insurance records are preserved and every concerned Member State will pay in accordance to the insurance period completed there. The total pension of an individual will be the sum of payments from these countries. There is a guiding principle that no contribution should be lost. However, several countries consider only periods longer than a year sufficient for starting to pay a pension. In such case, the other Member States proving the individual with a pension should take into consideration these uncovered months when calculating the pension. (European Commission, 2010c)

Though the pension of a mobile worker is paid by several countries, there is no need to apply for pension many times. A person should apply to the institution issuing pension in the state of residence. If the person has never been employed in there, then the appropriate institution of the Member state where he/she last worked must be contacted. The institution that has been contacted will manage the pension claims in other member states and exchange necessary information. Document P1 will be issued which is a summary that describes the pension entitlement from all the Member states concerned. (European Commission, 2010c) Receiving pension from various countries means in practice separate payments to your bank account. Those from different currency may result in transaction costs such as fees by banks for transferring sums in foreign currency.

3.1 Mobility of pension for cross-border workers

The term cross border worker can be used to refer to frontier and migrant workers. According to a definition, a frontier worker is an employed person who pursues his occupation in a different Member State from the one in which he resides and to whom he returns at least once a week (European Commission, 2010c). The social security of a frontier worker is covered by the country of employment. Even the worker, who remains as resident of the ‘old’ state of employment, is insured under the legislation of the ‘new’ state where currently employed. Thus the worker will receive separate pension from each state where insured for at least one year. Issues related to the taxation of a frontier worker are more complex. There can be risk of double taxation but the situation is usually covered by bilateral agreements between Member States.

The term migrant worker will be used here to refer to a person who has taken up employment in another Member State and has moved for that purpose. Both employed and self-employed migrant workers are insured in the country where they work. Being insured, the migrant worker has to make the payment of social security contributions and is in return entitled to health care, social security benefits and future pension rights. (European Commission, 2010c) Identical to frontier worker, a migrant worker who has been employed in many Member States will receive pension from each country. Taxation of a migrant worker is typically more straightforward, since the place of employment and residency are in the same country.

There is a principle that a person is subject to the legislation of only one Member State at a time. This means that a person, who works in more than one Member State at the same time, is subject to the legislation of the state of residency. However, if this is not the state where substantial part of activity is carried out then an employed person is subject to the legislation of the Member State in which the registered office or place of business of the employer is situated. (European Commission, 2010c)

3.2 Mobility of pension for posted workers

Posted worker is a person who is normally employed in one state but is sent temporarily to another state to work there for the same employer. The situation must fulfil certain conditions e.g. the employee must not be sent to replace another person. The maximum length of a posting is 24 months. (European Commission, 2010c)

Posted workers are covered by their home country social security system if they wish so. EU portable document 'A1' (former E101 and E103) should be obtained from the home state by either the employee or the employer. This certifies that the employee remains insured at the state where he/she normally works meaning also that the contributions of social security system continue to be paid to that state. (European Commission, 2010c) Also, provided that the posted worker stays abroad for less than 183 days a year, they usually pay taxes to their home country. (Europa.eu, 2011b) Hence the pension of a posted worker is gathered based on home country rules.

4. The cases of Estonia and United Kingdom

Next, the pension systems of Estonia and the United Kingdom are examined. These two countries are an example of a new EU member and an old member respectively. Afterwards the portability of pension from these countries is looked at.

4.1 Pension System in Estonia

The Estonian pension system is aimed to help a person to maintain his or her previous income and life standard after retirement (Estonia.eu, 2009).

The Estonian pension system has grown out of the relics of the Soviet era. Between the years 1997- 2002, the system was reformed to create the current three-pillar pension system. (Kulu and Reiljan, 2004) Figure 1 illustrates the Estonian pension system. The First Pillar constitutes the State Pension, the Second Pillar is mandatory funded pension scheme and the Third Pillar is voluntary private funded scheme. (Estonia.eu, 2009)

4.1.1 I pillar: State pensions

The First Pillar includes three employment related pension: Old Age Pension, pension for incapacity to work, survivor's pension. The forth type of pension in the First Pillar is the minimum or National Pension. This guarantees minimum income to people who do not qualify for employment-related pension but who have lived in Estonia for at least 5 years before reaching retirement age and do not receive pension from abroad. For the purpose of this study, the Old Age Pension will be explored in more detail. (Pensionkeskus, 2011a)

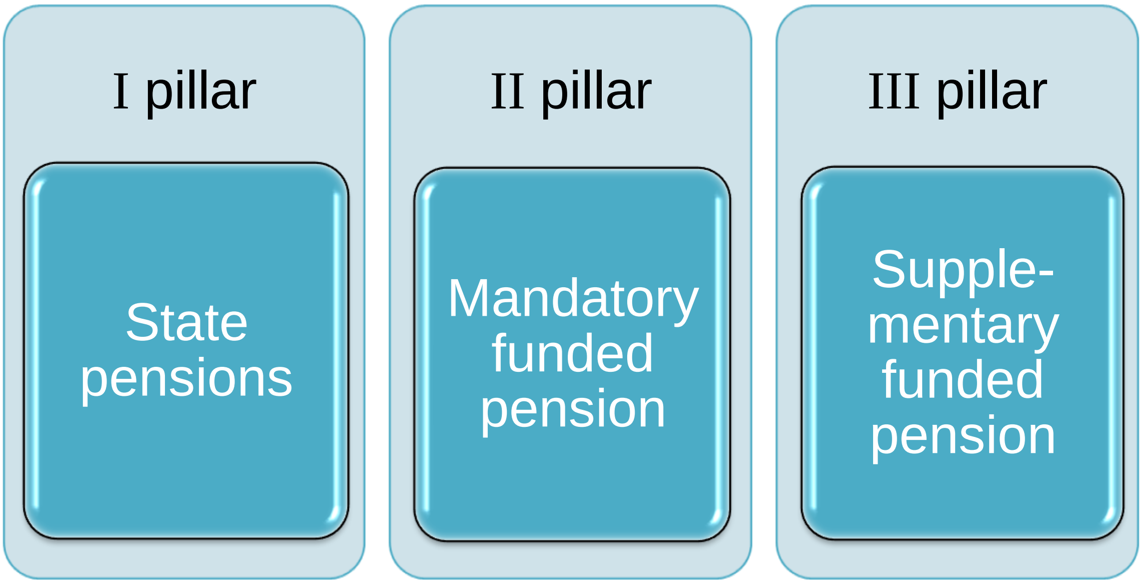

Figure 1. The Estonian pension system.

The Old Age Pension of the Estonian state can be claimed from the age of 63. There are plans to increase the age limit to 65 by year 2026. The requirement for receiving the pension is to have obtained at least 15 years of pensionable service (i.e. 15 calendar years in employment or in activity deemed equal such as child care); and to be a permanent resident or hold a temporary residents permit of Estonia. (Pensionkeskus, 2011a)

The state Old Age Pension is made up of three components (Pensionkeskus, 2011a):

1) the basic amount - this is a fixed sum paid to everyone qualifying for the state retirement pension. In 2011, the sum is 114,66 Euros.

2) length of employment/ pensionable service period component- this considers the years of pensionable service. These are counted up to year 1998 when the last pension reform took effect. Number of years employed is multiplied by a coefficient.

3) insurance component – this calculates the social security tax paid on the salary since 1 January 1999. The amount of the insurance component is calculated on the basis of the sum of annual factors of pension insurance. An annual factor shows the ratio of the Social Tax paid on the person's salary during the calendar year to the Social Tax paid on the average salary of the state. In Estonia, the Social Tax is paid by the employer on behalf of every employee.

The pension reform transfers the system such that the amount of the old age pension depends increasingly on the size of the salary or in other words on how much social security tax has been paid for the person. The Old Age Pension is a PAYG (pay-as-you-go) scheme meaning that the money collected today is immediately paid out to current pensioners. The actual amount of the pension cannot be calculated beforehand as it is dependent on the coefficients that the government sets based on the incoming Social Tax payments and the cost of living of that time.

4.1.2 II pillar: Mandatory funded pension

The Second Pillar of the pension system is a mandatory privately managed funded pension scheme. It is designed as the main support to the state pension. The Second Pillar is based on preliminary funding: an employee pays 2% of the gross salary to the pension fund and the state adds 4%. This 4% percent comes out of the Social Tax that is paid on the person by his/her employer (currently equal to 33% of gross salary). The money is invested in a Second Pillar pension fund operated on the private market. It is allowed to change the fund but not more that once a year. (Pensionikeskus, 2011b)

Subscription to the Second Pillar is compulsory to persons born 1983 or later. Joining the scheme is a binding obligation and it is not possible to stop contributions while employed. The payments can start from the age of receiving state pension (currently 63 years). It is not necessary to take out both pensions at the same time. For example a person may choose to start receiving state pension and postpone taking out the funded pension or the other way around. (Pensionikeskus, 2011b)

The amount of the collected sum is dependent on earnings and tax contributions and the length of time fund has been gathered. In addition, the choice of the fund is relevant. At retirement, depending on the size of the fund, the money can either be taken out directly from the fund or in the case of a large sum, an annuity must be bought.

4.1.3 II pillar: Supplementary pensions

The Third Pillar of the Estonian pension system consists of supplementary funded pension schemes. Joining the Third Pillar is voluntary decision and one person can hold many supplementary pensions. It can be done by making pension insurance contract with a licensed insurance provider or by acquiring pension fund units from a private fund manager. (Europa.eu, 2011c) Although the Third Pillar is a private pension, being part of the national pension system, the pension funds are regulated and supervised by the state. In addition, the Third Pillar is supported by the government through tax initiatives. For example the contributions to the pillar can be deducted from taxable income if they are limited to 15% of annual gross income. (Estonia.eu, 2009)

Payments from a Third Pillar fund can be received from the age of 55 or if becoming unable to work due to disability. There remains the right to take out the accumulated sum before reaching retirement but in that case full income tax must be paid. The pension payments out of a Third Pillar fund mean in practise selling back the fund units. In case of a pension insurance policy, a contract with the insurance provider must be made. (Pensionikeskus, 2011c)

4.2 Pension System in UK

The pension system of UK has its roots in the year 1909 when the first general old age pensions were paid out based on the Old Age Pensions Act of 1908. (BBC News, 2002) Though numerous reforms and changes, the pension system has taken its current form. Today the Department for Work and Pensions is the biggest public service delivery department in UK serving over 20 million customers. (DWP, 2009a) The British pension system aims to avoid old age poverty. The system is made up of state and private pensions (see Figure 2).

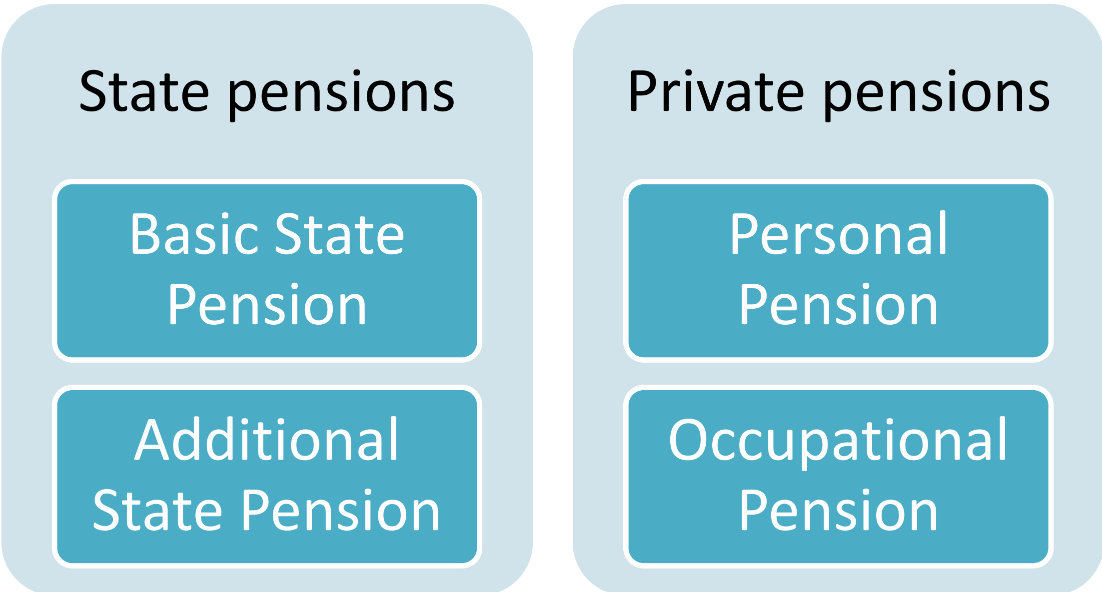

Figure 2. The UK pension system.

4.2.1 The State pensions

The basic State Pension is a pension paid by the government upon reaching retirement age. The State Pension is based on the number of qualifying years when the National Insurance Contributions have been paid or have been credited to the person. The credits are given for example for the time of being ill, unemployed or caring for someone. (Directgov, 2010a) The social security scheme of United Kingdom includes the national insurance scheme, which provides cash benefits for sickness, unemployment, death of a partner, retirement, etc. People earn entitlement to these benefits by paying National Insurance contributions. An employee pays primary Class 1 contributions as a percentage of weekly earnings up to a certain threshold. The contributions are deducted from salary. (Europa.eu, 2011d)

The amount of income at retirement depends upon the number of qualifying years. In 2010-2011 the maximum basic state pension is £97.65 per week. (Directgov, 2010b) Currently 30-44 years are required to be entitled to full basic State Pension. (Directgov, 2010a) The great difference is due to the fact that the system is being adjusted and the requirements vary for different age groups. The age for retirement is 65 for men. In April 2010, the State Pension age for women started to increase gradually from 60 years to reach 65 in 2018. From December 2018 the State Pension age for both men and women would start to increase to reach 66 by April 2020. (Directgov, 2010c) Possible further increases are under consideration. The pension can be claimed also if continue to work after the retirement age. Although the pension increases when claiming the pension is postponed. (Directgov, 2010b)

There is also available by the government an additional pension component called the Additional State Pension or the State Second Pension (S2P). This does not build up for people who are self-employed, earn less than a set sum each month or are contracted out. Until 6 April 2012, it is possible to contract out of the S2P by joining a suitable alternative pension scheme. The amount of the State Second Pension is calculated based on earnings and National Insurance Contributions made over working life. (Directgov, 2010d)

4.2.2 Private pensions schemes

In addition to the state pensions it is possible to have personal and occupational pensions. Occupational pensions are arranged by employers while personal pensions are arranged by individuals themselves in order to provide income for their retirement.

Personal pensions are always of money purchase type and can also be called defined contribution schemes. When owning a personal pension scheme, the individual makes constant payments into a pension fund operated by a bank, building society or a life assurance company. The size of the final pension pot depends on the contributions made and interests accumulated over the years. At retirement a lump sum of the fund can be taken out tax free. Most commonly the rest of the pension fund is used to purchase a lifetime annuity that secures a taxable income which is payable for the rest of life. The retirement income thus depends on the performance of the pension fund up to the retirement date and on the annuity rates available at that time. Personal pensions can be taken out even by people without employment incomes. In UK the personal pensions are available in the form of Personal Pension Plans and Stakeholder Pensions. (Redhead, 2003)

Occupational pensions can be final salary or money purchase type. The contributions to the pension fund can be made by the employer only or by both employer and employee. Final salary pension schemes link the size of the pension income to the employee’s salary at retirement. An alternative name for such scheme is defined benefit schemes because the benefits are specified rather than the means of financing them. Money purchase schemes operate like the personal pensions where payments are made into a pension fund and at employee’s retirement the employer uses the fund to buy an annuity. These are called also defined contribution schemes because it is the contributing payments that are set down by rules and not the final pension income. (Redhead, 2003)

4.3 Compliance with EU rules

It is important to notice that EU does not envisage one common pension system for all the union. Pensions are meant to stay the prerogative of Member States and their social partners because pensions are funded locally. However, Europe is faced by the common challenges of severe demographic ageing; impact of the recent financial and economic crisis putting restrains on budgets, capital markets, unemployment levels; and shortcomings in current pension systems. (European Commission, 2010a) EU has seen the need to address the common themes in a coordinated way to secure the functioning of internal market, to meet the requirements of the Stability and Growth Pact and in order to stay consistent with Europe 2020 strategy. Thus developing a framework that would include policy coordination and regulation has started in the form of e.g. the Green Paper 2010: ‘’Towards adequate, sustainable and safe European pension systems.’’

In European Union the EU law is superior to the national law. Thus, the portability of Estonian and UK pensions is influenced by the laws and regulations of the European Union. Here is examined the opportunity for a worker from Estonia and a worker from UK to take along their pension when going to work permanently or temporarily in another EU country.

4.4 Moving from Estonian pension system

In Estonia, a person who moves abroad retains the right to receive Estonian State Pension accumulated so far. The Old Age Pension is paid out in the form of bank payments upon reaching Estonian retirement age irrelevant of where in EU the person resides. Also payments from the Second Pillar can be received at the earliest at the age of 63 which is the current retirement age. The money from the Second Pillar cannot be moved before; it stays and continues to grow in the chosen fund in Estonia. The migrant worker will receive pension both from Estonia and the ‘host’ Member State if applicable.

The rules have a slightly different effect on people who have been employed abroad only temporarily and return to Estonia before retirement. The Social Tax is one of the crucial elements based on which the size of the First Pillar pension is calculated. The Social Tax payments that are stopped while employed abroad. As a result the size of the Old Age Pension provided by the state does not grow during that period. The other element to be considered is the length of employment.

It is very important that also periods of employment abroad are taken into account because of the requirement of 15 years of pensionable service to qualify for the Estonian Old Age Pension. This applies to people who wish to retire in Estonia. Periods worked abroad do also accumulate the years of pensionable service but only minimum of one year of pensionable service in an EU Member State, Norway, Iceland, Lichtenstein or Switzerland contributes towards pension. Any period shorter than 12 months is not considered. A proof of the length of service abroad (e.g. the employment contract) must be submitted to Social Insurance Board when applying for the pension. This is then added to years of pensionable service earned in Estonia. (Pensionikeskus, 2011d) Shorter periods are not accounted for and there is a risk that these do not give right for host State’s pension either.

Accordingly, working in another Member State does count towards pension in Estonia as it provides years needed to qualify for receiving State Pension. However, while working abroad no social security tax is paid and there is nothing added to the Second Pillar fund. The contributions into the Second Pillar come from tax and salary, both of which are operated through Estonian Tax and Custom Board that transfers the money to funds. As a result, the retirement income of a returned migrant worker is likely to be lower than that of a person who continued to make contributions because was employed only in Estonia for an equivalent period and salary. Although theoretically there is a possibility that the loss is compensated by the pension received from other states where employed.

A personal pension fund in the Third Pillar can stay in Estonia or the money can be taken out of the Pillar whenever suitable for the investor. In the latter case, the tax advantages are lost. In addition, premature cashing of the fund results in 2% fine that stays in the fund. (Pensionikeskus, 2011d)

The Third Pillar can be kept in Estonia, either for the purpose of returning to Estonia for retirement or for the intention of receiving the payments abroad. The contributions to the Third pillar can be continued while working abroad. Nevertheless, there are various aspects to consider. For example, there are still barrier to financial transactions when making payments across borders. Transferring money in different currency, banks typically charge for currency exchange and for ‘foreign payment costs’. Portability of the Third Pillar fund can be hindered for the related tax issues. For example, tax deductions may be lost when abroad and a tax payer of a different Member State. Yet, it is the tax incentives and security offered by the state that are the qualities that make voluntary pensions schemes a more appealing investment type for retirement saving than the alternatives. Consequently, a migrant worker can rely on receiving the statutory pensions from Estonia wherever in EU. However, the conditions and expenses attached to the voluntary Third Pillar could potentially become an obstacle to portability.

4.5 Moving from the British pension system

United Kingdom has adopted the EU requirements and exchanges information with other Member States’ pension institutions. The person who has moved out of UK is entitled to receive the pension in the extent accumulated based on the National Insurance Contributions made. The basic State Pension, and the additional State Pension likewise, is paid out to people living in any Member State. Hence an employee can easily move and claim for the UK pension via pension institution of the new home country. The State Pensions can be arranged to be paid directly on bank account. It will normally be paid to you either quarterly or four-weekly in arrears by a payable order negotiable through a bank. (Europa.eu, 2011e) In addition, the person will receive pension from other Member States where employed.

A migrant or cross-border worker who has returned to UK before reaching retirement age is also entitled to receive pension from all the EU countries where he/she has been employed. The claim for the pensions will be handled through UK Pension Service. Department of Work and Pension sends out a pension claim forms four months before a person is about to reach retirement age. On this form any periods of employment abroad can be stated. (DWP, 2009b) While employed abroad, no NI contributions are made and the size of the UK pension for the person does not increase. This of course does not apply to posted workers who accumulate pension rights similarly to those who are working in home country because they continue to pay NIC.

The portability of the State Pensions seems to be relatively uncomplicated due to the EU regulations. There could be more obstacles to portability of private pensions because of their more complex nature. With the great variety of private pension schemes in existence in UK, both in the form of personal and occupational schemes, merely some general ideas can be expressed here about the portability of such pensions. For example, the right to take money out depends on terms of the specific contract and usually there are exit costs. Concerning the occupational schemes, there can be complications even when changing employer within the country. A separate research in the details of such pensions should give a better understanding.

On the other hand, some personal pension schemes are less of an obstacle to free movement of labour. The reason is that the employee can continue to make contributions to the personal pension funds also from abroad. Hence the personal pension can be gathered as if staying in home country. In addition, the payments from the fund can later be received also when living abroad. Though, as mentioned before when examining the Estonian system, the tax initiatives could be lost and there may be hidden costs.

4.6 Analysing portability opportunities

The examination here relies greatly on drawing conclusions based on EU legislation and regulation and especially the EU guide on mobility (see European Commission, 2010b), supported by the data available on the web pages of the national pension institutions (see

Directgov.uk, Pensionikeskus etc.). The information available regarding mobility on these web pages seems to emphasise mostly the local issues. For example there is currently a trend in Estonia to go temporarily working abroad for a period of a few months or up to a few years. At the same time UK is a destination country and has more inhabitants who choose to go to spend retirement in Mediterranean climate. All these issues are reflected on the websites and guidance is given primarily on how to organise pension in such cases. The existence of the EURES (the EC portal for European jobseekers) and the EC guide '*'Your rights when moving within the European Union*'' shows that steps are taken to make it easier to comprehend issues related to mobility. Hence, it helps to lower the barrier by providing information. Yet, the specific details of pension portability are still not mentioned and are maybe not revealed until claiming for the pension. In addition, it can be questioned if the guide reaches its target. The Eurobarometer (2010) research studying the experiences of EU citizens who had exercised the right of cross border mobility revealed that barely a quarter of the respondents had visited the Europa.eu website during their search for information regarding the move.

Based on the information presented it can be suspected that there are delays in decision making and communication between the various pension authorities of Member States. For example DWP (2009b) warn about delays receiving the State Pension abroad. The Eurobaometer (2010) findings are in accordance: lengthy administrative procedures, as well as lack of clarity in administrative requirements, are mentioned as the main problem when moving within European Union.

The harmonizing effect of EU regulations is visible when looking at the mobility opportunities of pensions from Estonia and United Kingdom. Workers from both countries maintain their statutory pension rights when go to another Member State as is required by Regulation No 883/2004 and Regulations 987/2009. The principle of aggregation is practised by exchanging information with other Member States and enabling to receive retirement pension from several EU countries. Furthermore, free movement is supported through enabling pension payments to people residing elsewhere in EU. It becomes apparent from Estonian conduct that not all employment periods are considered. It is allowed by the EU regulations that the Member States do not have to provide pension for less than one year long employment on their territory. Although other countries should consider the period if issuing pension. (Europa.eu, 2011f) Of course the explanation for this practice is likely to be practical reasons, e.g. administrative costs and difficulties for calculating the pensions. Unfortunately such custom undermines short term mobility e.g. for seasonal work.

It must be highlighted that the EU regulations on social security coordination only cover statutory social security systems, including the state and mandatory pension schemes. The supplementary private pensions are not covered by these rules. This can be seen when looking at the example of Estonia and Great Britain. There is no guideline provided for the British private pensions because there is wide range of them. The particular contract between an employee and a provider of the private pension scheme lies down the rules for portability. In Estonia the situation is slightly different. The Third Pillar has existed only since 1998 and is under more specific national regulation.

The Council Directive 98/49/EC of 29 June 1998 is intended to guarantee preservation of vested supplementary pension rights for persons who go to work in another Member State and discontinue making contributions to the scheme. Furthermore, it ensures cross-border payments of supplementary pension schemes, net of any taxes and charges, to other Member States. (Europa.eu, 2006) The Directive 2003/41/EC of 3 June 2003 regulates occupational retirement provision and helps to create Europe wide market. (Europa.eu, 2010) However, there are concerns that the Directives are not comprehensive enough. Monti (2010) claims that the current regulatory framework cannot avoid losses for non-statutory forms of social protections and sees the portability of supplementary pensions and health insurance rights as specific problem hindering the free movement of labour. The European Commission (2010a) assesses correspondingly that the Directive provides only basic protection. For this reason the Commission has in the Green Paper on pensions (European Commission, 2010) called for consultation on ways how to improve the cross border activity.

4.7 Further discussion

The significance of statutory funded pensions is increasing across Europe. See Appendix 1 which illustrates the predicted share of occupational and statutory funded pensions in the total pension of selected Member States. In Estonia the pension reform has created statutory funded pension (the Second Pillar). This funded pension scheme is estimated to provide for nearly 40% of retirement income in 2046. It is very relevant to cross boarder workers from Estonia. When working abroad, it is possible for the Estonian worker to continue making payments to the Third Pillar. In addition, if the period of employment abroad last over an year, then the worker collects pension rights from the host country and ‘qualifying years’ that will on return hopefully enable to qualify for Estonian State Pension. However, the size of the Second Pillar is likely to shrink compared to the situation where the person had been employed in Estonia. This is because the ingoing payments are stopped. The payments to the Second Pillar can be made only while working in Estonia as the money moves to the funds through national social tax system.

In UK occupational and statutory pension funds have existed for a longer time and count already now for approximately 40% of the retirement income from the pension system. The percentage is supposed to increase slightly (see Appendix 1). However, there is the decrease in final salary occupational schemes. This is an important change taking place in the UK pension industry. There has been for some time a trend to offer money purchase schemes instead of final salary related ones. The reason for this is that the scheme has become unattractive for the employers in the private sector due to the Pension Act 1995, the accounting standard FRS 17 and poor investment returns of recent years. Pension experts claim that final-salary schemes, which typically guarantee to pay two-thirds of a worker's last pay cheque, became one of the biggest costs to companies when the financial crisis hit in 2007. Employers' pension contributions doubled over the last decade to £46.1bn, according to official figures. Ros Altmann, an independent pension’s analyst, has said that final salary schemes would require increasing contribution from employers in the next few years. (Inman, 2009) Hence, it can be expected that the final salary related pension schemes become even rarer as companies try to cut costs. There are thus obvious benefits for a company for preferring defined contribution schemes but the advantages for the employees is that they can more directly influence the growth of the pension fund and it is also typically easier to transfer such scheme when changing employer.

The British State Pension is a Defined Contribution (DC) scheme and the Estonian pension system is also to be DC scheme due to the reforms. The trend in Europe to move towards DC schemes can be seen as supporting labour mobility. Palmer (2005) points out in his article that the conditions of many defined benefit (DB) schemes have the effect of locking employees into a workplace. He brings the example of occupational pension scheme liked to final salary. Such scheme discourage especially older employee from changing jobs. Furthermore, leaving a DB scheme can mean being excluded from that point from the future growth of the fund. As a contrast, stopping contributions to a DC scheme does not prevent growth of the input already made. He suggests that the DC schemes are neutral on labour mobility between jobs, occupations and countries since DC schemes allow free movement of labour without penalisation through the pension system.

When considering the consequence of the move towards greater reliance on DC schemes, the importance of financial literacy is highlighted. Under these schemes the duty of planning, choice and also responsibility is transferred from the scheme organiser to the individual. This requires economic literacy and planning skills from the individual. In particular, making reasonable decisions about the supplementary and private pension schemes is challenging, especially the choice of appropriate fund type and the need to buy an annuity at retirement. The importance of all these skills emphasises when involved in cross border activity because understanding of more than one system is required and in addition of the regulation governing the mobility between those systems. Pension systems are rather complex and there is no opportunity to rely on previous experience while making pension decisions. At the same time, it is a very crucial decision because it affects the welfare of a person possibly for many years. In an article by Sundén (2006) it is shown with examples from Sweden and USA that individuals have limited knowledge about the pension systems and their own pension plans. Also the fact that the appropriate EU portals were little used (Eurobarometer, 2010) suggests low awareness of EU framework regarding pensions. Here could recommend more education to increase the financial literacy. In addition, the idea suggested by European Commission (2010a) to establish a pension advice service could help the situation.

It is important to bear in mind that while the EU coordination provisions apply to social security matters, there is no coordinating framework for taxation. Taxation is under each Member States authority, thus taxation practices vary greatly across the Union. This poses further problems for mobile workers. In addition to different social systems it is necessary to familiarise with taxation systems and specific requirements. Additionally, there is the need to understand bilateral agreements that can exist between some Member States. This again highlights the need for high financial literacy.

Taxation issues are complex especially for mobile workers who move from tax system to another. In 2010 the European Commission drew attention in the Green Paper on pension systems to discriminatory tax rules as an obstacle to the mobility of pensions. The Court of Justice has ruled (Commission vs. Belgium Case C-522/04) that it is against EU law to tax transfers of pension capital from domestic pension funds to funds elsewhere in the EEA if such transfers between domestic pension funds are tax free. The Commission is still to examine if there are any other Member States violating against this rule. (European Commission, 2010a) Another aspect of taxation to consider is tax incentives. States have designed tax reliefs to encourage people to save for retirement in supplementary pension funds. For example, in Estonia the contributions to the Third Pillar are tax deductable and in certain cases reduced income tax applies to the payments out of the fund. (Pensionikeskus, 2011c) The tax advantages can be lost when working abroad and hence resident of another state for tax purposes. If the tax incentives are lost, it could be more profitable to save for pension in other forms of investment. There are available various other financial market products and long term investment opportunities (e.g. investing in property).

Saving for pension is typically a long term commitment. The long time scale increases the risk of unforeseen events that influence pensions. The latest financial crises have put strains on government budget and PAYG schemes have turned into burdens. (Buttonwood, 2010) The recent developments in Hungary present an example of the risk that whole pension systems can be reformed and laws and regulations can be changed. There a three pillar system is changed back into a two pillar scheme by requiring people to merge the mandatory pension funds operated on the private market with the state pension system. (Bereczki, 2010) Another kind of an example can be found from the past; in 1997 Mr. Brown eliminated tax credit on dividend payments which had a direct negative impact on the income of pension funds. (Buttonwood, 2010)

5.Recommendations

Based on the information presented, it can be suggested that in a situation where there is a choice, an employee should prefer at least 12 month work contract abroad over a shorter one. The reason is that work periods in another Member State that last at least a year are certainly accounted for in pension calculations. The current situation creates opportunities for institutions selling personal pensions. There could be niche for special premium product of pension insurance or fund for mobile worker. From the aspect of pensions, the mobility of posted workers seems to be the most straightforward with pension being accumulated in the country of origin. Highly mobile workers should avoid occupational pension schemes to reduce the risk of losing out on pension. It is likely to be more beneficial to negotiate for the employee to contribute into their personal pension fund. For example in Estonia employers are able to make tax deductable payments into Third Pillar funds of their employees. (Kruusamaa, 2011)

The employers can benefit from the knowledge that instead of a generous occupational pension package, contributions to the employees fund may be more valued and attractive. This is supported by the evidence that remuneration is one of the strongest motivators. Gustman and Steinmeier have studied the relationship between pensions and job mobility in the United States. In their book Pension Incentives and Job Mobility, they show that compensation is the single most significant determinant of mobility. (Pensions and mobility, 1995, cited in The Workinglife Report, 1995). From economic approach individuals decide to migrate to increase their standard of living. Due to this basic principle of migration people move to areas with higher wage level. (Öberg, 1997)

6. Conclusion

It can be concluded that the pension systems are an internal affair of the Member States without Union wide harmonization. The governments of Estonia and UK have designed the pension systems according to how they have seen best. However, to encourage free movement, EU coordinates cross border activity of social security issues including statutory pensions. The coordination is establish in the Treaty on the Functioning of the European Union under the Article 48, Regulation (EC) 883/2004 and Regulation (EC) 987)2009. This has had a direct positive influence on the portability of both Estonian and British state pensions. The countries pay the statutory pensions to those eligible irrespective of where in EU they reside and also the principle of aggregation is implemented. The supplementary private pension schemes lack an equivalent EU regulative framework. This is reflected in less clarity for mobility options and represents an obstacle for free movement of labour. There is also reference in literature to problems with statutory pensions suggesting that in reality the portability is not as easy as it should be. Hence, though steps have been taken to improve the portability of pensions, there is still room for improvements.

The current dissertation can be improved by trying to finding more statistical data on mobility. For example, statistics on the number of EU citizens receiving their pension from outside their country of residence. Also the taxation element can be expanded. This can be done by including the examination of Estonian and UK tax systems. The current work can be used as a preliminary research for further study. The topic could be investigated further buy conducting a qualitative research to discover the personal experiences of cross boarder workers and especially of those who have retired recently. In addition, study can be designed to discover if pension is among the issues considered by a person planning to go to work abroad. Such study can be supplemented by exploring the population’s awareness of pension systems and the EU regulation on social security benefits.

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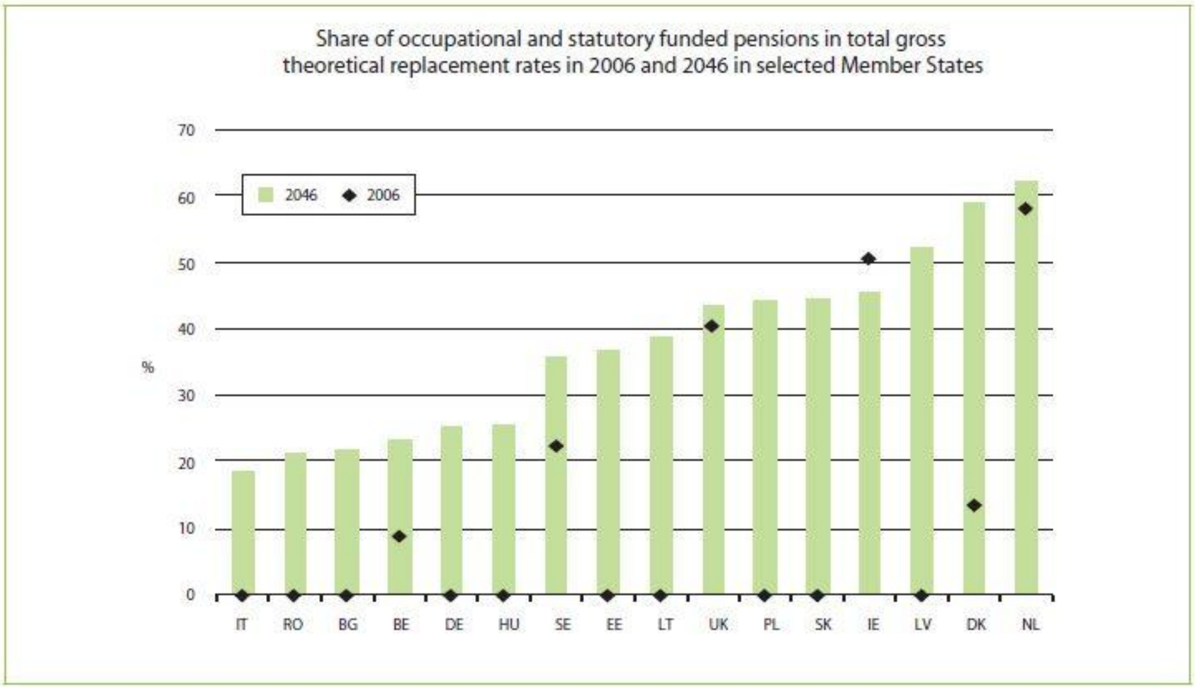
APPENDIX



Source: European Commission, 2010a, p.33 (based on Indicators' Subgroup of the Social Protection Committee 2009)

Replacement rates measure the extent to which pension systems enable typical workers to preserve their previous living standard when moving from employment to retirement.